LOS ANGELES BAR BULLETIN

In This Issue

Vol. 34 **JUNE 1959** **No. 8**

Los Angeles

BAR BULLETIN

Official Monthly Publication of The Los Angeles Bar Association, 241 East Fourth Street, Los Angeles 13, California. Entered as second class matter October 15, 1943, at the Postoffice at Los Angeles, California, under Act of March 3, 1879. Subscription Price $2.60 a Year; 40c a Copy.

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The President's Page

FRIVOLOUS COURT PROCEDURES

HUGH W. DARLING

George Harnagel's always interesting "Brothers-In-Law" section in the January issue of the BULLETIN quoted a unique rule recently adopted by the United States District Court for the District of Oregon providing that an attorney who presents an unnecessary motion or who otherwise multiplies the proceedings in a case may be required personally to satisfy the resultant excess costs. In addition the culpable barrister is subject to "such other discipline as the court deems appropriate."

The rule reads harsh. If arrogantly applied it might be too harsh and in the long run do more harm than good. But if it will aid in reducing the shameful backlog of unresolved litigation that is plaguing court calendars throughout the land, with Los Angeles County a front runner despite the studied efforts of the local Bench and Bar, much good will come of it.

If application of the rule should result in discouraging the filing of justifiable complaints or forcing inequitable settlements or retarding the submission of meritorious motions and demurrers the consequences would be melancholy. Still the benefits that could flow from a fair but firm use of the rule would seem to justify this risk.

The Bench must bear its share of the blame for the sluggishness of judicial procedures. Some judges, perhaps leaning over back-

wards to see that every litigant has his full day in court, are too reluctant to sustain a demurrer without leave or to entertain favorably a motion to strike a complaint or grant a summary judgment. Likewise some judges, perhaps again leaning over backwards to be courteous to counsel, are not stern enough with aberrant advocacy or sufficiently insistent on keeping a trial within reasonable but tight bounds. In consequence too many cases come to court that should have been sterilized in Law and Motion and too many legitimate one-day trials burn up five days.

But the Bar is more to blame for the mounting jam of litigation than the Bench. Too many lawsuits are spawned that should not be. Too many time consuming demurrers and motions to strike are presented that are meritless or aimed at a technically valid though otherwise valueless result. To this should be added protracted direct and cross examination, frequently futile, laced with pointless objections lumbering under vacuous haranguing.

Easy judges and clumsy lawyers are in the small minority but they account in good part for the bulging warehouse of unclosed case files.

In this great State of ours we have a few provisions designed to put a damper on legal frivolity—C.C.P. § 2034 and Rule 26 of Rules on Appeal are examples. But these rather soft provisions are not often implemented and have proved insufficient to do the job for which they were designed.

Let's hope that the talons in the new Oregon rule can be used in a fashion that will claw out some of the few cankers in our judicial processes without molesting the healthy muscles. Should that prove to be so we ought to hustle it on the books down here.

Some Bankruptcy Consequences of Defective Security Transactions

By GEORGE M. TREISTER*

If there still exists any doubt that the Bankruptcy Act packs a tremendous wallop for secured financing, it should be laid to rest by the recent opinion of the Ninth Circuit in *Miller* v. *Sulmeyer,* 263 F. 2d 513. (Rehearing denied April 17, 1959.) Here a trustee in bankruptcy completely invalidated a chattel mortgage which was good for the most part under applicable California law. The lesson to be learned is that when bankruptcy ensues, errors of omission or commission made in connection with security transactions can have greatly magnified effects.

The *Miller* case involved these facts: In June 1954, appellants sold a machine shop business to the bankrupt for $200,000, payable $11,000 in cash with the balance secured by a purchase money chattel mortgage on the machinery and equipment being transferred. Because of the neglect of one of their trusted employees, appellants failed to record the mortgage for 79 days. At the time of bankruptcy in late February 1955, there were still in existence about $9,000 in creditors' claims—mainly for federal withholding taxes—which had arisen during the interim of delayed recordation.

The bankrupt defaulted on its secured obligation to appellants almost immediately. Accordingly, in December 1954 appellants exercised their right to repossess the chattel mortgaged assets, and sold them in March 1955 to a bona fide purchaser at public auction for $82,500, their then fair value. Bankruptcy occurred between the repossession and the sale, but this fact would not seem to be significant.[1]

Appellants filed a claim with the Bankruptcy Court for the deficiency on the purchase price of the business, after giving credit for the net monies received on the chattel mortgage foreclosure sale. The trustee counterclaimed for $82,500, contending that the tardy recordation rendered the chattel mortgage invalid under California law as to some creditors, and therefore entirely void in bankruptcy under Section 70e of the Bankruptcy Act. He also asserted that the mortgage was invalid under Section 70c. The Referee

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[1]In California, the chattel mortgagee's repossession of the property does not cure the damage done by the late recordation. *Noyes* v. *Bank of Italy,* 206 Cal. 266 (1929).

awarded judgment on the counterclaim, but only for $9,000, the extent to which the mortgage would have been vulnerable outside of bankruptcy. On the trustee's petition for review, District Judge Ben Harrison ruled that Section 70e of the Act required a reversal; he gave judgment to the trustee for $82,500, less certain credits which are unimportant here. The Ninth Circuit affirmed.

There is no doubt but that the mortgage could have been attacked under California law by certain of the bankrupt's creditors. Section 2957 of the Civil Code requires prompt recordation. While no specific time is set forth in the statute, delays in filing of far less than 79 days have been held to be fatal in other cases, apparently as a matter of law.[2] Outside of bankruptcy, however, the recording law protects, or gives rights to, only those creditors who have claims which arose before the tardy recordation; no matter how long the delay, the chattel mortgage is invulnerable to attack by those extending credit after the instrument is placed of record.[3]

In the *Miller* case, therefore, so far as the state law was concerned the mortgage was good except for a maximum possible risk of $9,000. As a practical matter, moreover, it probably would have stood up completely but for the bankruptcy. This was because federal taxes comprised almost $8,000 of the claims arising before recordation, and although the United States as a creditor is protected by the recording law, the tax collector apparently never chooses to pursue his rights under Civil Code Section 2957.[4] The remainder of the bankrupt's pre-recordation indebtedness was owed to four trade creditors, none of whom had a claim large enough to justify the expense of investigation and litigation necessary to a successful suit against the chattel mortgagee.

Why did the intervention of bankruptcy change the result so dramatically to the detriment of the mortgage holder? Two sections of the Bankruptcy Act supply the answer in the *Miller* case, namely 70e and 70c. Section 70e provides in effect that a transfer or mort-

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[2]See, e.g., *In re Hansen*, 268 Fed. 904 (S.D. Calif., 1919); *In re Kessler*, 90 F. Supp. 1012 (S.D. Calif., 1950).

[3]E.g., *Wolpert v. Gripton*, 213 Cal. 474,481-482 (1931).

[4]There is no reported case in California where the United States itself has sued a creditor of the taxpayer to invalidate a defective security under Civil Code Section 2957 or under similar statutes. Perhaps this practice of the Government not to enforce its rights under state laws protecting creditors generally involves a policy or public relations decision not to bring litigation to collect taxes from a taxpayer's transferee except under the specific provisions of the Internal Revenue Code which create transferee liability. A more likely explanation, however, is the fact that a greater staff than is available to the Director would be necessary to discover the defective transfer in time to make suit against the transferee an effective course. (The cases where the United States relies upon the federal tax lien law to bring it ahead of competing secured claims are distinguishable.)

gage made by a bankrupt which for any reason is voidable under state law on the date of bankruptcy by any creditor having a provable claim is "null and void" as to the trustee.[5] This provision was construed in 1931 in *Moore* v. *Bay,* 284 U.S. 4, a decision written for a unanimous Supreme Court by Mr. Justice Holmes. The characteristically cryptic style makes it difficult to distill the full import of the holding from the opinion alone, but the record and the reported decision of the lower court[6] leave no doubt what was decided. The case arose in California and involved a chattel mortgage which was partially invalid because of failure to comply with the notice filing requirement of former Section 3440 of the Civil Code. The penalty for omitting the notice, like that for tardy recording, was to render the security defective only as against creditors coming into existence before recordation. The argument made in *Moore* v. *Bay* by the mortgagor's trustee in bankruptcy was clearly set forth in the lower court's opinion in that case:

> "It is the contention of appellant [Trustee] that, under Section 70e of the Bankruptcy Act . . . , the mortgage in question, being void as to one creditor or class of creditors, is void in toto at the suit of the trustee."[7]

The Court of Appeals rejected this contention, holding that the trustee obtained no greater rights than the creditors who could attack the mortgage under state law:

> "There is no express language in this section [70e] which specifically gives to any unsecured creditor of a bankrupt any greater rights or any secured creditor any less right than he had before adjudication in bankruptcy. The rights of a trustee in bankruptcy to 'avoid any transfer' are no greater than those of a creditor or particular class of creditors. It is clear, we think, that a trustee in bankruptcy is limited in his control and disposition of the estate of the bankrupt to the rights of creditors as such rights existed and could be enforced under the state law prior to the time proceedings in bankruptcy were instituted."[8]

After granting the trustee's petition for certiorari, the Supreme Court reversed this decision. Therefore, despite Mr. Justice Holmes' failure to spell it out in any detail, *Moore* v. *Bay* necessarily held that the trustee's power under 70e is to knock out completely a defective transfer, even though it could be attacked only to a limited

[5]Section 70e does not use the word "mortgage," but refers to a defective "transfer." The latter term, however, is defined broadly by Section 1(30) of the Bankruptcy Act to include every means of creating an interest in or lien upon property.

[6]In the lower courts, *Moore* v. *Bay* was carried under the caption *In re Sassard & Kimball,* 45 F.2d 449 (C.A. 9, 1930).

[7]45 F.2d at 450.

[8]45 F.2d at 450.

extent by the creditor or creditors from whom the power is derived. That is to say, for Section 70e purposes there must exist at least one actual creditor as to whom the transfer is invalid; but once this is established, the quantum of the trustee's recovery is not measured by the creditor's rights. The opinion also announces a second principle, namely, that the recovery thus made by the trustee is to be distributed pro rata to all the bankrupt's creditors in accordance with the distributive scheme of the Bankruptcy Act, and not merely to those claimants who could have challenged the transfer under state law.[9]

That *Moore* v. *Bay* established the first of these propositions as well as the second was recognized by a number of the commentators who noted the case at the time.[10] Since 1931, no reported decision has denied that Section 70e renders a transfer completely void as to the trustee if it is voidable in part by creditors of the bankrupt. On the contrary, the rule has been clearly stated in opinions of the Second,[11] Fourth,[12] Fifth,[13] Sixth,[14] and Eighth[15] Cir-

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[9]The commentators have generally agreed that this second principle established by *Moore* v. *Bay* is sound bankruptcy law. As to the first principle, however, a marked difference of opinion exists, see notes 28 and 29, *infra,* although the controversy concerns only the wisdom of the proposition and not its existence.

[10]See, e.g., 45 Harv. L. Rev. 579; 21 Calif. L. Rev. 59; 18 Va. L. Rev. 249, 265-269; 20 Geo. L.J. 229.

[11]*City of New York* v. *Rassner,* 127 F.2d 703, 707 (C.A. 2, 1942); *American Trust Co.* v. *New York Credit Men's Adjust. B.,* 207 F. 2d 685, 689 (C.A. 2, 1953); cf. *Zamore* v. *Goldblatt,* 194 F. 2d 933 (C.A. 2, 1952), *cert. den.* 343 U.S. 979.

[12]*Friedman* v. *Sterling Refrigerator Co.,* 104 F. 2d 837, 840 (C.A. 4, 1939).

[13]*Corley* v. *Cozart,* 115 F. 2d 119, 121 (C.A. 5, 1940).

[14]*General Motors Acceptance Corporation* v. *Coller,* 106 F. 2d 584 (C.A. 6, 1939) *cert. den.* 309 U.S. 682; *Trailmobile, Inc.* v. *Wiseman,* 244 F.2d 76 (C.A. 6, 1957); *Oliver Machinery Co.* v. *Bissell,* 261 F.2d 596 (C.A. 6, 1958).

[15]*Mercantile Trust Co.* v. *Kahn,* 203 F.2d 449 (C.A. 8, 1953).

FEDERAL COURTS INDIGENT DEFENSE PANEL

The following attorneys voluntarily served on The Federal Court Indigent Defense Panel during April 1959.

Albert D. Barouh	Ronald E. Landers
Wendell Buttrey	Allan L. Leonard
Ben Crocker	John F. McKenna, Jr.
Robert M. Dulin	Melvin W. Miller
Robert S. Forsyth	Floyd H. Norris
Jason A. Gottlieb	Robert Priver
Hurley A. Graffius	Irwin E. Sandler
Myron E. Harpole	Esther Speakman
D. Clifford Higgins	F. G. Stapleton
John Hinchey	Emil M. Stranz
Murray Jackson	

TAX REMINDER

INCOME TAX DANGER IN TRANSFERRING MORTGAGE PROPERTY TO A TRUST

By LEON B. BROWN*

The selection of property for gifts in trust is at best a difficult problem. The grantor hesitates to use assets which have greatly appreciated in value, thereby denying the trust beneficiaries the increase in basis they would get if they received the same property by will; yet he dislikes using property which has declined in value, for he thereby denies himself the benefit of a deductible loss on its sale. Often the only suitable property, having a value not greatly disporportionate to its adjusted basis, is nevertheless worth more than the grantor cares to part with. In such a case his natural inclination is to "thin out" the gift by encumbering the property with a mortgage or other lien as security for a loan to himself and then transferring the property so encumbered to the trust.

If the grantor yields to this inclination he may find, to his sorrow, that the trust income used to pay off the loan will be treated as income "distributed" to him, within the meaning of Section 677 of the Internal Revenue Code of 1954, and therefore includable in his own tax returns.

If the gift were made directly to the donees, rather than in trust for their benefit, there would be no basis whatsoever for holding the income from the property taxable to the grantor, even if it were all used to pay off the encumbrance. The same would be true, if the property having been transferred in trust, the trustee then sold it to a third party who used the income to pay off the debt. It therefore seems most unjust to apply Section 677 merely because the property is held in the trust and the income is so applied. There is no doubt, however, that in the case last mentioned the income paid on the secured indebtedness *is* taxable to the grantor. The Supreme Court so held in *Helvering v. Blumenthal,* 296 U.S. 552 (1935), affirming 30 B.T.A. 591 on the authority of *Douglas v. Willcuts,* 296 U.S. 1, which holds that a grantor is taxable on trust income used to discharge his legal obligations.

In the *Blumenthal* case the grantor was entitled, under the trust indenture, to participate in the trust income after the indebtedness was fully discharged, and this was pointed out in *Edwards v. Green-*

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wald, 217 F. 2d 632 (1954), as a ground for distinguishing that case. However, the Tax Court has held that it makes no difference, in applying the rule of the *Blumenthal* case, that the grantor retains no interest, present or future, in the corpus or other income of the trust. *Clifton B. Russell,* 5 T.C. 974, 983 (1945). And this is the view of the Commissioner of Internal Revenue, as expressed in Rev. Rul. 54-516, where the trust was exclusively for the benefit of the grantor's children, but the Commissioner nevertheless warned that "if the grantor assumes liability in any capacity, other than as trustee, for the mortgage on the real estate transferred to the trust, any income of the trust which is used to pay principal or interest on such mortgage will be taxable to him," citing the regulations under a section of the 1939 Code substantially identical with Section 677 of the present Code.

A second ground for the decision in *Edwards v. Greenwald* was that in that case the trustee had expressly assumed the obligation to pay off the secured indebtedness, thereby making the grantor only secondarily liable. Such an assumption creates a relationship of principal and surety between the parties. 33 Cal. Jur. 2d 655.

Issue Editor—Robert B. Krueger

The court said the trust income used to discharge the debt could not be taxed to the grantor unless he was primarily liable. If this were so, it would be easy in all cases to avoid the tax by having the trustee assume the debt. Unfortunately, the Commissioner does not recognize this limitation on the rule of the *Blumenthal* case. It is significant that in Rev. Rul. 54-516, ***supra,*** he speaks of the grantor being liable for the mortgage "in any capacity"; and that ruling was recently cited in Rev. Rul. 54-564 as authority for the proposition that where property is transferred to a trust on condition that the trustees pay the gift tax on the transfer, income used by the trustee for that purpose is taxable to the donor under Section 677. The trustee's acceptance of the property on the condition stated amounted to an assumption of liability, making the grantor only secondarily liable, but that was enough for the Commissioner.

The rule of the *Blumenthal* case should have no application, however, where the grantor has no personal liability for the indebtedness secured by the property transferred in trust and the trust is exclusively for the benefit of others. This would be true, for example, if the property is real property which was mortgaged by the grantor's predecessor in interest and the grantor acquired it without assuming the mortgage debt, or if, before transferring the property in trust, he obtained a release of personal liability from the mortgagee. It is true that in *Loeb v. Comm.,* 159 F. 2d 549 (7th Cir. 1946), the grantor was taxed on trust income used to pay off a secured indebtedness for which he had no personal liability, but that was because he had already contracted to apply the future income from the property to payment of the encumbrance and the trust used the income to discharge that contractual obligation. The case should ordinarily be distinguishable.

In a short-term trust, one in which the property is to be returned to the grantor after a term of years, any use of trust income to pay off an encumbrance on the property will necessarily benefit the grantor, even if he is not personally liable for the debt. Special caution is required whenever encumbered property is to be used as the *res* of such a trust.

In all cases in which the use of income to pay off secured indebtedness may make the income taxable to the grantor, it would seem desirable, in order to avoid the broad scope of Section 677, expressly to restrict the trustee to the use of depreciation reserves or other corpus for the purpose of discharging the encumbrance.

Taxation: Reserved Life Estates

COMMENT ON A NEW POSSIBILITY FOR ESTATE PLANNING

By JOHN R. COHAN*

In March 1932, Congress acted to foreclose forever the possibility that a person could exclude from his gross estate for Federal estate tax purposes the value of property in which he had reserved a life estate.[1] In April 1958, the U.S. Supreme Court by its 6-3 decision in *Fidelity-Philadelphia Trust Co. v. Smith*[2] may have pointed out the manner in which this result can still be achieved. *The Fidelity-Philadelphia Trust* case also points out a method by which an uninsurable individual may obtain life insurance which he can then give away and have the life insurance proceeds escape estate taxation. The *Fidelity-Philadelphia Trust* case indicates that these two results may be achieved through the use of combined single premium life insurance policies and non-refundable life annuity policies.

The *Fidelity-Philadelphia Trust* case presents the typical fact situation for the use of this device. In 1934, Mrs. Haines, then aged 76 years, purchased three single premium life insurance policies on her own life aggregating $350,000 face value without the requirement of a medical examination. However, as a condition to selling Mrs. Haines each life insurance policy, the company required her to also purchase a separate single premium non-refundable life annuity policy. The non-refundable annuity policy made it impossible for the company to lose any money on the life insurance contract; as a matter of fact, the size of the annuity was calculated so that in the event Mrs. Haines died prematurely, the annuity premium less amounts allocated to the annuity payments already made would combine with the companion life insurance premium to equal the amount of the insurance proceeds to be paid. Each annuity policy could have been purchased separately at the same price.

In the year of purchase, Mrs. Haines assigned the life insurance to her children and paid a gift tax. Mrs. Haines died in 1946 and her Executors took the position that the proceeds of the life insurance policies were not includable in her estate.[3]

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[1]Joint Resolution dated March 3, 1931, reversing the result in *May v. Heiner*, 281 U.S. 238,50 S.Ct. 286 (1930).

[2]78 S.Ct. 730, 58-1 U.S.T.C. Para. 11761, (April 28, 1958).

The Executors maintained that the annuity payments were income from the annuity policies which were property separate from the insurance policies. Since the decedent had assigned the life insurance policies to her children she retained no interest in them at her death. Thus, the Executors argued, such policies were not includable in the decedent's estate.

On the other hand, the Commissioner of Internal Revenue established that the effect of the transaction was to eliminate any insurance features since the insurance company took no risk; thus the insurance provisions of the Code[4] did not apply. However, the Commissioner maintained that the decedent had transferred property (life insurance) to her children reserving the income from the property (the annuity) during her lifetime. Property transferred in such a manner is subject to the estate tax under specific provisions of the Internal Revenue Code,[5] so that the proceeds of the insurance policies were includable in decedent's estate.

The Supreme Court held for the taxpayer and excluded the proceeds of the life insurance policies from the gross estate of the decedent. It pointed out that prior to death the decedent had di-

[3]The Commissioner of Internal Revenue assessed a deficiency which was paid and thereafter a claim for refund was filed. The refund claim was denied and a district court suit resulted in judgment for the taxpayers. See 142 F.Supp. 561, 56-2 U.S.T.C. Para. 11630 (D.Ct. E.D.Pa.). The Court of Appeals for the Third Circuit reversed the District Court, 241 F.2d 690, 57-1 U.S.T.C. Para. 11683.

[4]1954 I.R.C. Sec. 2042; 1939 I.R.C. Sec. 811(g).

[5]1954 I.R.C. Sec. 2036; 1939 I.R.C. Sec. 811(c)(1).

vested herself of all interests in the policies and that the assignees were the owners of the policies without any limitations on their rights.

The Government to prevail, said the Court, would have to establish that the annuity payments were derived as income from the entire investment. This it could not do. While admittedly each life insurance-annuity combination was the product of a single integrated transaction at the time of purchase, the parties neither intended nor acted as if any of the transactions would have a quality of indivisibility. Two items of property—an annuity policy and an insurance policy—were purchased even though the life insurance company hedged by issuing a combination annuity-life insurance combination. Thus, the annuity policy could have been acquired separately at the same cost, and the life insurance policy could have been, and in fact was, conveyed separately. Moreover, the obligations of the insurance company on the annuities were not in any way conditioned on the continued existence of the life insurance contracts, which the assignee could have relinquished for their cash surrender value.

This decision of the Supreme Court resolved a split in the Circuit Courts.[6] Justices Burton, Black and Clark, in their dissenting opinion cited the lower court cases which had reached a contrary conclusion. They argued that in substance this case was indistingushable from one in which a settlor places a sum in trust reserving the income of the trust fund during his lifetime and designating beneficiaries to whom the principal shall be payable upon his death.

The Fidelity-Philadelphia Trust case will enable a taxpayer to employ combined life insurance and non-refundable life annuity policies to retain the income from his aggregate investment for life from an economic point of view, without subjecting the principal thereof to estate tax on his later death. Though Congress thought it had thwarted this objective twenty-six years ago, taxpayers may be able to employ combined life insurance and non-refundable life annuity policies without adverse estate tax consequences until Congress acts again.

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[6]The Seventh Circuit reached the same result as the Supreme Court in *Bohnen v. Harrison* 199 F.2d 492, 52-2 U.S.T.C. Para. 10,876 (7th Cir. 1952), affirmed by an equally divided court 345 U.S. 946, 53-1 U.S.T.C. Para. 10,900(1953). The Second and Sixth Circuits reached a contrary result in *Burr v. Commissioner* 156 F.2d 871, 46-2 U.S.T.C. Para. 10503 (2d Cir. 1946); *Conway v. Glenn* 193 F.2d 965, 52-1 U.S.T.C. Para. 10838 (6th Cir. 1952).

REMINISCENCES of the EARLY BAR of LOS ANGELES

PART III

This is the concluding installment of an address given by Mr. J. A. Graves, one of the pioneer members of the Los Angeles Bar, to the Seventeenth Semi-Annual Dinner of the Los Angeles Bar Association on October 15, 1909. In addition to other portions of this address which can be found in the March and April issues of the 1959 Bulletin, Mr. Graves set down his reminiscences of early California in two entertaining and colorful books, CALIFORNIA MEMORIES, *Times-Mirror Press (1930), and* MY SEVENTY YEARS IN CALIFORNIA, *Times-Mirror Press (1927).**

To show you that Los Angeles County did not monopolize all of the jokes of the profession, I will relate an incident that occurred in Judge McKee's Court room. He was Judge of the Third Judicial District of California, embracing a portion of San Francisco, and his Court room was in the Mechanics Institute Building on Post street, in that city.

Just out of college, I entered the office of Eastman & Neumann, of San Francisco, on July 8, 1873, to begin my legal education. I spent much of my time between that date and the time I came to Los Angeles, in 1875, in securing "time" for Paul Neumann. If there was any one thing Paul wanted more than he wanted a drink, it was "time" to demur, answer, move for a new trial, or do any old thing that falls to the lot of a practicing attorney.

One day in the Spring of 1875 he drew an order extending time to answer, and told me to go up and get Judge McKee to sign it. "If the Judge is busy, don't get him angry by breaking in on him, but just sit down until he is ready to adjourn; otherwise he might not give me the time, and I would be compelled to devote my massive brain to drawing this answer, when I do so much want to go to the Club and play a little poker," was his parting advice as I departed on my mission.

*Other subjective histories of this period can be found in Harris Newmark, *Sixty Years in Southern California 1853-1913*, Houghton Mifflin Co. (1930); Glenn S. Dumke, *The Boom of the Eighties in Southern California*, Huntington Library (1944); Marco R. Newmark, *Jottings in Southern California History*, The Ward Ritchie Trusts (1955); Ludwig Louis Salvator, *Los Angeles in the Sunny Seventies—A Flower from the Golden Land*, Bruce McCallister-Jake Zeitlin (1929).

On getting to Judge McKee's Court room a little after ten o'clock, I found the trial of an important ejectment suit, involving large real estate holdings on Brannan street in San Francisco, engaging the attention of the Court. The flower of the San Francisco Bar—then the ablest Bar in the world—was there. Hall McAllister, Joe Hoge, Sam Wilson, Sidney M. Smith, W. H. Patterson, John B. Felton and Ben Brooks, among others, were engaged in the trial.

The date of the erection of a fence enclosing the disputed property seemed to be an important element of the fight. Ben Brooks called a poor, battered wreck of humanity to the stand who said his name was Mike Kelly. He testified that he was a hostler in a livery stable; that he knew the land involved; that he was a hostler in a livery stable on Brannan street in August, 1853—twenty-two years before. Brooks then asked him if he knew when the fence in controversy, describing it, was built. He said he did. He then asked him when it was built. "On the 5th day of August, 1853," he replied. Brooks then turned him over to Hall McAllister, who cross-questioned him at great length, and after much wrangling and wordy warfare between the attorneys, they got from him that he fixed the date by a memorandum in a dirty-looking book which he produced from his pocket. He explained that he owned the first thoroughbred fox terrier bitch that came to California. He claimed that he brought her around the Horn in a sailing vessel, and her name was "Boston Belle;" that on the 5th day of August, 1853, he had mated her with Mulligan's "Prince Tom," and when he was taking "Boston Belle" to the amorous embraces of "The Prince," he passed the place where the fence was being erected, and "the carpenters were nailing the boards on the posts." McAllister struggled with him until the noon recess, and finally, with the weary air of a baffled cross-examiner, having been unable to shake his testimony, he announced, "That is all." Mike left the witness stand and proceeded a few feet when Judge McKee, who was taking notes at his desk and who talked with his teeth closed, called out to him, "Hold on!" Mike stopped, did not return to the witness stand, but remained standing. Judge McKee wrote a moment or two, and then, looking up over his glasses, he said, "Mike, did the bitch have pups?"

He then adjourned Court and I procured my order extending time.

About this time, Johnie Tuers, an actor in the old Bella Union Theater (called a theater, but the worst dive in San Francisco), killed a fellow-actor. Reuben Lloyd and James G. Eastman defended him. His case was pending before Judge S. H. Dwinelle of the Fifteenth District, whose district embraced a part of San Francisco and Contra Costa Counties. Lloyd & Eastman moved for a change of venue. They sent me to the jail with a notary to get Tuers' affidavit. They had drawn an affidavit and attached it to the Great Register of San Francisco, in which Tuers stated "that he knew every man whose name appeard in the Register; that these men would constitute the jurymen from which the jury drawn to try him would be drawn; that each of them was prejudiced against him, had expressed opinions as to his guilt, and that he could not get a fair and impartial trial in San Francisco." After he had made the affidavit, I said to him, "Johnie, have you no compunctions of conscience as to that affidavit?" He laid his hand on my shoulder and said: "My boy, if you were in my place, you would much rather take the chances of going to San Quentin for perjury than to be hung for murder."

Dwinelle granted the motion for a change of venue, and transferred the case to his own district in Contra Costa County. After two or three trials, Tuers was acquitted and afterwards died.

My friends, I have already trespassed upon your time and patience. While much could yet be said on this subject, I must desist. But I cannot leave you without paying a slight tribute to the memory of two of my closest friends, each an intellectual giant—John S. Chapman and Stephen M. White, lately of the Los Angeles Bar. I was thrown into intimate contact with both of these men for many years. While in some respects alike, in others they were utterly dissimilar. They were alike in the simplicity of their lives and characters. They never realized their greatness. They were alike in that each of them had completely mastered the great fundamental principles of all law and of all justice. They differed in temperament. White was cheerful in demeanor, hopeful, and always confident; Chapman, gloomy, despondent and fearful of results. Chapman shrunk from, White sought the applause of clamoring multitudes. They differed in the manner in which they applied their vast knowledge of the law to the practical affairs of men. Chapman acquired his legal knowledge by slow processes and the hardest kind of work. White acquired his

intuitively, but he rounded out his knowledge of it by close and earnest application. Chapman was the profoundest, White the most versatile lawyer I ever met. They were associated together in much important litigation. Chapman profited by the spur of White's more active mentality, White by Chapman's closer reasoning powers and more cautious mental analysis of legal conditions governing the subject under investigation. Chapman was the clearest and deepest thinker, White the most aggressive advocate. White was the past master of invective, Chapman of persuasion. To win a jury, Chapman would not stoop to any of the tricks of the demagogue. White would, but always moved by honest impulses. Chapman enveloped a jury, just as the rising tide on a peaceful summer sea envelopes the rocks on the shore-line—slowly, surely, without noise, without tumult. White carried all before him, with irresistable assault, just as the mountain stream, swollen to undue proportions by torrential rains, sweeps everything before it to destruction. Chapman relied upon a calm and dignified appeal to reason; White took a short cut by an appeal to passion. White conquered by the force of his will, Chapman by the power of his intellect. They achieved the same result by different processes. They traversed the profoundest depths of the realms of thought by routes unknown to other men. They laid the foundation for many victories by burning late the midnight oil, while others slept or spent the priceless hours in thoughtless idleness. We are all better off for having known these men. They have preceded us to that mysterious shore we know nought of, Chapman dying from long-continued mental drudgery, and the mental and physical slavery he had unconsciously yielded to and could not shake off. White died a victim of an unquenchable ambition, under the stimulus of which he destroyed his health and wrecked his life. They have left us the living memory of two kindly, gentle spirits who sprung from the people, raised themselves, through industry and ability, to positions at the Bar that any man, in any land or in any age, could well have envied them.

Contemplating the achievements of these two men, we must conclude that the human race is still progressing and advancing in intellectual development. I rejoice that these men were my friends, that I had their respect and confidence, and that they loved and trusted me.

SOME BANKRUPTCY CONSEQUENCES OF DEFECTIVE SECURITY TRANSACTIONS

(Continued from page 231)

cuits, in more than a few state and federal district court cases,[16] and in the writings of the leading authorities on bankruptcy[17]—not to mention the many citations of *Moore* v. *Bay* under circumstances where a reader cannot determine definitely which of its two principles it is being cited for.

Thus, the Court was compelled by precedent in the *Miller* case to reach what it thought was a harsh result. Oddly enough, however, even though the problem is a common one in bankruptcy litigation, *Miller* is the first clear application by the Ninth Circuit of the rule concerning the trustee's complete power of avoidance under Section 70e since the reversal in *Moore* v. *Bay* itself.[18]

The Court's rejection in *Miller* of one of the arguments made in the appellants' brief points up the fact that the trustee's 70e power is not limited to a four month reach-back as are certain of his other powers of avoidance.[19] The contention was advanced that since the chattel mortgage was recorded and perfected as against subsequent creditors more than six months before bankruptcy, it was invulnerable to challenge by the trustee. The Third Circuit had so

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[16]E.g., *Tatelbaum* v. *Nat'l Store Etc. Co.*, 196 Md. 599, 78 A. 2d 228 (Ct. of App. Md., 1951); *In re Tobias*, 150 F. Supp. 288 (W.D. Mich., 1957); *In re Higgs*, 126 F. Supp. 16 (E.D. Mich., 1954); *Deane* v. *Fidelity Corporation of Michigan*, 82 F. Supp. 710 (W.D. Mich., 1949); *In re Independent Distillers of Kentucky*, 34 F. Supp. 708 (W.D. Ky., 1940); *In re Johnson*, 23 F. Supp. 337 (W.D. Mich., 1938); *In re Consolidated Oil Company*, 140 F. Supp. 614 (E.D. Mich., 1956).

[17]E.g., 4 Collier on Bankruptcy, Par. 70.95, pp. 1533-1536; 1 Glenn, Fraudulent Conveyances and Preferences (Rev. Ed. 1940), pp. 567-568; MacLachlan on Bankruptcy (1956), Sec. 285, pp. 333-334.

[18]The closest the Ninth Circuit had previously come was in *England* v. *Sanderson*, 236 F.2d 641 (C.A. 9, 1956), a case involving the extent of a bankrupt's homestead exemption as against his trustee. Section 6 of the Bankruptcy Act preserves to the bankrupt property which is exempt from execution under the law of the state of his domicile. Prior to September 9, 1953, Section 1260 of the California Civil Code provided a $7,500 homestead exemption for heads of family. On that date the section was amended to raise the allowance to $12,500. Under the California decisional law, however, such an increase operates only prospectively outside of bankruptcy; as to creditors whose claims arose before September 9, 1953, the exemption remained at the $7500 figure. *In re Rauer's Collection Co.*, 87 Cal. App. 2d 248.

The question in *England* v. *Sanderson* was whether the bankrupt, adjudicated in 1954, had a $12,500 or $7,500 exemption in bankruptcy, there being actual existing creditors whose claims arose before 1953. The Court gave him the lower amount in a decision which seems to say that by virtue of Sections 6 and 70c of the Act, the homestead as to the trustee is no greater than the minimum for which it would have been good as against any *actual* creditor under state law. Section 70c, however, has nothing to do with the rights of actual creditors, as is seen in the text, *infra*. Moreover, since a declaration of homestead is not a "transfer" within the statutory definition of that term, Section 70e—and, therefore, *Moore* v. *Bay*—would seem to have no bearing on the point. What the Ninth Circuit really did in *Sanderson*, however, although the opinion is obscure, was to transplant the *Moore* v. *Bay* doctrine into the exemption context of Section 6. The *Miller* v. *Sulmeyer* decision applies the same principle straightforwardly in a 70e action where it belongs.

[19]For example, the trustee can avoid judicial liens under Section 67a of the Bankruptcy Act and preferences under Section 60 only if they arose or were made within the four months preceding bankruptcy.

held in the case of a mortgage belatedly filed in Pennsylvania. *In re Consorto Const. Co.,* 212 F. 2d 676 (C.A. 3, 1954). But the *Consorto* situation is only superficially similar to that in *Miller,* the distinction turning on the difference between the Pennsylvania and California recording laws. In Pennsylvania, a late filing perfects the security as to all creditors except those who have actually levied on the mortgaged property before the recordation. Because there had been no levy in the *Consorto* case, none of the bankrupt's creditors could have attacked the mortgage at the date of bankruptcy, regardless of whether their claims arose prior to or after the recordation. The trustee therefore was powerless unless he could set aside the security as a preference under Section 60 of the Act, a section which contains a four month period of limitations. On the other hand, most California laws which are designed to protect creditors, including the one providing for the filing of chattel mortgages, permit the protected class of creditors to assail the defective transaction even after it has become perfected. Specifically, a creditor of the mortgagor can levy on the mortgaged property after the delayed recordation so long as his claim arose before.[20] This fact enables a California trustee to invoke the creditor's rights under Section 70e, without regard to the four month period, provided the state statute of limitations—which is usually two years or more—has not expired on the claim prior to bankruptcy.[21]

While the Ninth Circuit's application of *Moore* v. *Bay* in the *Miller* case introduces nothing new into the law of Section 70e, the Court's discussion of the trustee's power under Section 70c does concern a doctrinal matter of relative novelty. Section 70c, sometimes referred to as the "strong-arm" clause, provides:

> "The trustee, as to all property, . . . upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, *whether or not such a creditor actually exists.*" (Emphasis added.)

Until the Second Circuit's decision in *Constance* v. *Harvey* in 1954, 215 F. 2d 571, it was not believed that the strong-arm clause conferred any power upon the trustee to nullify a transaction which became perfected before bankruptcy, no matter how recently the

[20] E.g., *Ruggles* v. *Cannedy,* 127 Cal. 290, 298-302 (1899).
[21] The Third Circuit in its *Consorto* opinion, 212 F.2d 676, recognized that the result turned on a construction of the Pennsylvania recording act which was different from the one given the California statute by courts of this state.

perfection had occurred. That is to say, the prevailing view was that the trustee's strong-arm rights arose on the date of bankruptcy, without relation back or the added power of a creditor who might have extended credit theretofore. But *Constance* proved to be a bombshell. It involved a tardily filed chattel mortgage in New York, a state under whose recording law the effects of a late filing are the same as in California. In an opinion on rehearing, the Court noted that a hypothetical creditor of the bankrupt-mortgagor could have levied on the mortgaged assets on the date of bankruptcy, provided only that he had extended credit before the recordation. This being the case, the Court ruled that Section 70c gave the trustee a lien on the property superior to that of the chattel mortgagee, despite the fact that there might not exist any creditor whose claim actually arose prior to the recordation.

The Supreme Court denied certiorari in *Constance* v. *Harvey*.[22] Although the decision might be justified as a matter of literal construction of the strong-arm clause alone, 70c when read in context with other provisions of the Bankruptcy Act would not seem to go so far. The *Constance* construction of the strong-arm clause makes Section 70e and *Moore* v. *Bay* superfluous. Since a hypothetical creditor will always have rights at least equal to those of an actual creditor, it is hard to see why the trustee would ever use Section 70e in jurisdictions following the *Constance* rule. Moreover, inasmuch as the trustee's rights under 70c do not derive from an actual creditor or creditors, *Constance* makes unimportant the principle of *Moore* v. *Bay* which enables the trustee to invalidate transfers to a greater extent than actual creditors could.

Until *Miller* v. *Sulmeyer*, only the Second[23] and Seventh[24] Circuits had construed 70c in the manner of *Constance* v. *Harvey*. Now the Ninth Circuit apparently has joined the fold.[25] For while *Constance* is not cited, the opinion in the *Miller* case quotes the strong-arm clause, states that it "only requires a hypothetical creditor not a real one," and concludes:

> ". . . this court just cannot get away from the proposition that if the mortgage was subject to attack under California law by any creditor *or even by the creditor who wasn't, but who*

[22]348 U.S. 913.

[23]In a case arising after *Constance* v. *Harvey*, the Second Circuit again construed 70c in the same way. *Conti* v. *Volper*, 229 F. 2d 317 (1956).

[24]*In re Kranz Candy Co.*, 214 F. 2d 588, 591-592 (C.A. 7, 1954).

[25]In *England* v. *Sanderson*, 236 F. 2d 641, 643, n.7, discussed in note 18 *supra*, the Ninth Circuit cited *Constance* v. *Harvey* with apparent approval in a footnote; but in fact Section 70c was not there applied and the purpose of the citation is somewhat obscure.

> *might have been,* then the bankruptcy act and *Moore* v. *Bay,* supra, permit the trustee to demolish the creditor's security although partially valid under state law (*or even wholly valid in some circumstances because of the absence in fact of a certain type of creditor*)." (Emphasis added.)

Constance v. *Harvey* has been criticized by the commentators,[26] and legislation which would overrule it was introduced in the last session of Congress.[27] *Moore* v. *Bay* also has its critics,[28] although it has staunch and respectable defenders as well.[29] In any event, the Court in *Miller* v. *Sulmeyer* had no choice but to invalidate the chattel mortgage, at least under Section 70e, unless it was to strike out on its own in total disregard of the holdings of the Supreme Court and the other Courts of Appeal.[30] Since the principles involved are applicable not only to chattel mortgages, but also to other security devices and outright transfers of property, lawyers will do well to keep an eye on the possible bankruptcy consequences of every business transaction.

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[26]E.g., Marsh, *Constance* v. *Harvey—The "Strong-Arm Clause" Re-evaluated,* 43 Calif. L. Rev. 65 (1955); Seligson, *Bankruptcy,* 30 N.Y.U.L. Rev. 558, 559-563. For a recent decision questioning the correctness of the *Constance* rule and refusing to follow it, see *In re Billings,* 170 F. Supp. 253 (W.D. Mo., 1959).

[27]H.R. 5195, introduced February 21, 1957 by Congressman Celler.

[28]See, e.g., MacLachlan on Bankruptcy (1956), Secs. 284-285.

[29]E.g. 4 Collier on Bankruptcy, Par. 70.95, pp. 1533-1536; 1 Glenn, Fraudulent Conveyances and Preferences (Rev. ed. 1940) pp. 567-568; Schwartz, *Moore* v. *Bay—Should Its Rule Be Abolished?* 29 J. Nat'l Assoc. of Referees in Bankruptcy (No. 2, April 1955).

Re-examination of the reach of 70e at this late date is prevented not only by the overwhelming weight of the case law, but also by the apparent stamp of approval which Congress gave *Moore* v. *Bay* in 1938 when it added the following language to Section 70e(2):

"All property of the debtor affected by any such transfer shall be and remain a part of his assets and estate, discharged and released from such transfer and shall pass to, and every such transfer or obligation shall be avoided by, the trustee for the benefit of the estate."

Opinion of the Committee on Legal Ethics Los Angeles Bar Association

OPINION NO. 254

(December 19, 1958)

PRIVILEGED COMMUNICATIONS. Disclosure of Confidential Information. Propriety of Attorney's Disclosure of Information to Other Attorney Which was Received in the Course of Representation of Client in a Previous Matter.

The propriety of conduct with respect to the following facts was requested by an attorney:

> Attorney A was retained by plaintiff P to institute a civil action on behalf of P. Shortly before the trial, A associated attorney B as co-counsel to handle the trial of the case. Thereafter B met privately with P to prepare for depositions and for trial. During these conferences between B and P (A was not present), P made certain disclosures material to the issue of damages in the case. These disclosures, however, if made public probably would result in P being held both civilly and criminally liable for income tax evasion. Upon the advice of B, P agreed to forego and waive in the trial the item of damages which would reveal the violations indicated.
>
> Prior to trial P's action was dismissed for failure to bring the case to trial within five years. P thereupon brought an action against A alone (B is not a party in the action) for malpractice. A has retained attorney C to represent him in the malpractice action. C has asked B to furnish C with a written statement of everything that B knows about P's original action. C also has advised B that B may be called as a witness in the malpractice action.
>
> QUESTIONS PRESENTED:
>
> 1. May B make a full disclosure to C of everything which he knows about the dismissed action?
> 2. May B make a full disclosure to A of everything which he knows about the dismissed action?

The questions propounded include questions of law the determination of which may depend upon resolving disputed facts. This Committee does not render opinions on matters of law, and, of course, cannot resolve disputed facts. However, as a question of ethics is so closely involved, the Committee deems it appropriate to respond to the inquiry.

Section 1881(2) of the California Code of Civil Procedure provides, in part, that "An attorney cannot, without the consent of

his client, be examined as to any communication made by the client to him, or his advice given thereon in the course of professional employment . . ." It is well settled that "This privilege is strictly construed since it suppresses relevant facts that may be necessary for a just decision" (*City & County of San Francisco v. Superior Court,* 37 C.2d 227, 234). It is equally well settled, however, that the privilege "cannot be invoked unless the client intended the communication to be confidential" (*City & County of San Francisco v. Sup. Ct., supra*). Whether the client intended the communication to be confidential is a question of fact which must be resolved before the question of privilege may be answered.

Canon 37 of the A.B.A. Canons of Professional Ethics provides, in part, that "It is the duty of a lawyer to preserve his client's confidences. This duty outlasts the lawyer's employment . . ." Canon 37 further provides, however, that "If a lawyer is accused by his client, he is not precluded from disclosing the truth in respect to the accusation . . ." It is to be noted that when an attorney is "accused" he is only permitted to disclose the truth "in respect to the accusation." Thus, an omnibus disclosure of everything which an attorney knows about a case may well go beyond this limitation. (See 97 C.J.S. 808.) This too presents a question of fact which must be resolved before the question as to the extent of the privilege or waiver may be answered.

In the present situation, as A has been "accused," A may disclose to his attorney C "the truth in respect to the accusation." By bringing the malpractice action against A, P has waived the privilege as to A to the extent indicated. It has been held, however, that "When a person has two attorneys, an express waiver as to one does not amount to a waiver as to the other" (97 CJS 870, citing *Wilson v. Ohio Farmers Ins. Company,* 73 NE 892, 164 Ind. 462). As B has not been sued in the malpractice action, he has not been "accused" and does not come within the waiver of Canon 37. And, as indicated, the waiver as to A, does not amount to a waiver as to B. It necessarily follows that B may not disclose to C any information which he received from P in confidence during the attorney-client relationship between B and P.

Whether B may make a full disclosure of everything which he knows about the action to A, depends upon a number of factors, viz:

(1) If at the time P made the prejudicial disclosure to B

he authorized B to disclose the information to A, B could disclose the information to A, as the privilege does not attach to a communication which is not intended to be confidential (*Holm v. Sup. Ct.*, 42 C.(2d) 500, 506).

(2) If at the time P made the prejudicial disclosure to B he instructed B not to disclose the information to A, B would be bound by the privilege thus imposed by P and could not disclose the information to A (Cf. 97 CJS Sec. 281, p. 795-797, and cases there cited).

(3) If at the time P made the prejudicial disclosure to B he imposed no restrictions upon B so far as disclosure to A is concerned, the question is then presented as to whether there was implied consent by P for B to make a disclosure to co-counsel A. Our research has failed to disclose any authority directly in point on this question. The authorities do hold, however, that where two attorneys are engaged as co-partners in the practice of law that knowledge obtained by one is constructive notice to the other (*Wittenbrock v. Parker*, 102 Cal. 93). This rule should be the same as between co-counsel in a given case, even though they are not partners in practice. If the knowledge obtained by one is constructive notice to the other, it would seem that in the absence of any restrictions imposed by the client, there would be implied consent for one co-counsel to disclose information received from a client to his co-counsel so long as the action was pending, the attorneys remained associated, and the attorney and client relationship continued. In the matter here presented, however, the action in which B was co-counsel is no longer pending, and A and B are no longer associated, and the attorney-client relationship has been terminated. Our research has failed to disclose any authority directly in point on whether the constructive notice between co-counsel or implied consent to disclose to co-counsel is revoked under these circumstances. This is a matter which will have to be resolved before the question under consideration may be answered.

To summarize, the right of B to disclose to A information furnished to him by P might be held to be limited to the restrictions imposed by Canon 37 "in respect to the accusation;" whether P authorized B to disclose the information to A, instructed B not to disclose the information to A, or was merely silent as to such a disclosure, might well develop into a disputed issue of fact between P and B; and, the right of B to disclose to A might be held to be terminated by the dismissal of the action, the termination of the co-counsel relationship between A and B, and the termination of

the attorney-client relationship. In *Holm v. Sup. Ct.*, 42 C (2d) 500, the court, in discussing the matter of privilege, held:

> "In any given situation it is necessary that a determination be made concerning the fact asserted as a basis for the privilege. This determination is for the trial court in the first instance . . ." (pg. 507).

Until such time as the court has ruled on the matters hereinabove set forth, either in discovery proceedings or at the time of the trial, it is the opinion of this Committee that B should make no disclosures to A.

This Opinion, like all other Opinions of this Committee, is advisory only (By-Laws, Art X, Sec. 3).

Brothers-In-Law

By George Harnagel, Jr.

George Harnagel, Jr.

"Magistrates come to the bench with a wide variety of experience and background. These are reflected in their sentences. There are Judges who regard sex offences as the worst of all. Others reserve their special disapproval for gambling, narcotic addiction or drinking. There are Judges who feel the most heinous crimes are those committed with weapons. There are Judges who favour the prosecution and Judges who tend to favour the defence. There are severe Judges and there are lenient Judges.

"Aware of these variations, what ought Judges to do?

"It is not an easy matter for an individual clearly to see his own intellectual and emotional biases, though most people have them, but because more than in any other profession a Judge is in a position to impose the pattern of his personal reaction on the individuals over whom he has some control, his particular pattern is of greater importance.

"Periodically he should assess his bias pattern in order to make a determined, a conscious and a continuous effort to keep it from showing in his sentences. This may be more difficult for Judges than for most others. A sentencing Judge particularly risks the danger of developing the notion that both as a man and as an official he is omniscient and omnipotent."—From an address, *A Layman Looks at Magistrates,* delivered before a conference of magistrates of the Province of Manitoba by E. W. H. Brown, manager of the Hudson Bay Company store in Winnipeg.

* * *

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The Board of Directors of the **Detroit** Bar Association is making plans to construct a headquarters building in the city's new Civic Center.

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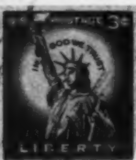

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